

Message Text

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ACTION EA-14

INFO OCT-01 ISO-00 SPC-03 AID-20 EB-11 NSC-10 RSC-01

CIEP-02 TRSE-00 SS-20 STR-08 OMB-01 CEA-02 CIAE-00

COME-00 FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06

SIL-01 L-03 H-03 PA-04 USIA-15 PRS-01 INT-08 SCEM-02

DODE-00 SCI-06 DRC-01 /174 W
----- 099560

R 280720Z NOV 73

FM AMEMBASSY TOKYO

TO SECSTATE WASHDC 8419

C O N F I D E N T I A L SECTION 1 OF 2 TOKYO 15431

PASS TREASURY AND FEDERAL RESERVE

E.O. 11652: N/A

TAGS: EFIN, JA

SUBJ: UNCERTAIN ECONOMIC PROSPECTS

SUMMARY: CONSIDERABLE DISAGREEMENT AMONG GOJ AGENCIES IN INTERPRETING RECENT ECONOMIC INDICATORS. EPA, NOTING ECONOMY HAS LOST MOMENTUM, FEELS IT MAY NOW BE AT INCIPIENT STAGES OF RECESSION. ON OTHER HAND, BOJ BELIEVES DEMAND REMAINS STRONG AND THAT PREVIOUS ANTI-INFLATIONARY STRATEGY SHOULD BE CONTINUED. IN ADDITION, THERE ARE WIDE DIFFERENCES OF OPINION REGARDING THE ECONOMIC IMPACT OF CUTBACKS ON CRUDE OIL IMPORTS. THIS LACK OF CONSENSUS ON ECONOMIC PROSPECTS MAKES IT EVEN MORE DIFFICULT FOR GOJ TO DETERMINE OVERALL ECONOMIC STRATEGY FOR THE YEAR AHEAD. IF ECONOMY ALREADY IN RECESSION, POLICIES MAY NEED TO BE CHANGED MARKEDLY FROM THOSE CURRENTLY BEING INVOKED. NEW FINMIN FUKUDA, WHO HAS CONSERVATIVE VIEWS ON ECONOMIC MANAGEMENT, WILL FACE DIFFICULT TASK OF DESIGNING STRATEGY THAT WILL NOT ONLY CURE SERIOUS INFLATIONARY SITUATION BUT AVOID PLUNGING THE ECONOMY INTO RECESSION.

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1. MANY CURRENT ECONOMIC INDICATORS SUGGEST SLOWDOWN IN GROWTH IN AGGREGATE PRODUCTION. RISE IN REAL GNP (SEASONALLY ADJUSTED) SECOND TO THIRD QUARTERS ESTIMATED AT ONLY 0.5 PERCENT (WITH NOMINAL GNP UP 4.8 PERCENT). MOREOVER, QUARTER TO QUARTER INCREASES HAVE BEEN PROGRESSIVELY SMALLER (I.E. FROM 3.3 PERCENT IN FIRST QUARTER TO 1.5 PERCENT IN SECOND AND 0.5 PERCENT IN THIRD). INDUSTRIAL PRODUCTION INDEX SHOWS VERY SIMILAR QUARTER TO QUARTER GROWTH TREND OF 6.7 PERCENT IN FIRST QUARTER TO 3.5 PERCENT IN SECOND AND ONLY 2.0 PERCENT INCREASE IN THIRD. OTHER SEASONALLY ADJUSTED INDICATORS OF DEMAND PRESSURES CONFIRM SLACKENED GROWTH RATE. NEW MACHINERY ORDERS DROPPED AFTER JUNE, CONSTRUCTION ORDERS (PRIVATE SECTOR) DROPPED 16.7 PERCENT FROM AUG TO SEP, AND HOUSING STARTS ROSE ONLY 2 PERCENT IN THIRD QUARTER COMPARED WITH 9 PERCENT RISE IN SECOND QUARTER. RATE OF INVENTORY ACCUMULATION EVIDENTLY HAS BEEN LARGER THAN HAD BEEN REALIZED AND SUGGESTS THAT SUPPLY RUNNING AHEAD OF DEMAND. IN ADDITION, EPA'S DIFFUSION INDEX OF LEADING INDICATORS RECORDED SOMEWHAT LOWER DEGREE OF "OVERHEATING" IN SEP.

2. EPA (MIYAZAKI) INTERPRETS THESE DEVELOPMENTS AS CLEAR SIGNS THAT THE ECONOMY IS BEGINNING TO SLACKEN AND PRESSURES ARE EASING. DESPITE DIFFICULTY OF MAKING FIRM FORECAST DURING CURRENT TRANSITIONAL PERIOD, EPA APPARENTLY PROJECTING REAL GNP GROWTH IN JFY 73 AT ONLY 9 PERCENT (ASSUMING UNRESTRICTED IMPORTS) IN CONTRAST TO OFFICIAL GOJ FORECAST OF 10.7 PERCENT INCREASE ANNOUNCED IN JAN, AND JERC FORECAST AT THAT TIME OF 11.3 PERCENT. ANNUAL INCREASE OF ONLY 9 PERCENT IMPLIES AVERAGE GROWTH IN EACH OF LAST TWO QUARTERS OF FY ONLY 2.6 PERCENT.

3. ANALYSTS AT BOJ BELIEVE EPA INTERPRETATION OF CURRENT SITUATION TOO PESSIMISTIC. CONSIDER THIRD QUARTER GNP ESTIMATE AS VERY ROUGH FIGURE WHICH MAY ALSO BE SUBJECT TO INCORRECT SEASONAL ADJUSTMENT. FURTHERMORE, ECONOMY WAS UNDER SERIOUS SUPPLY CONSTRAINTS DUE TO SHORTAGE OF WATER, ELECTRICITY AND PLASTICS NECESSITATING PRODUCTION CUTBACKS IN MANY INDUSTRIES AT THAT TIME. THESE FACTORS CAN EXPLAIN STAGNANT PRODUCTION DURING THREE MONTHS

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MAY-JULY. AS THOSE CONSTRAINTS EASED, PRODUCTION INDEX HAS

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R 280720Z NOV 73

FM AMEMBASSY TOKYO

TO SECSTATE WASHDC 8420

C O N F I D E N T I A L SECTION 2 OF 2 TOKYO 15431

RESPONDED TO STRONG PREVAILING DEMAND CONDITIONS BY IN-
CREASING 3.9 PERCENT FROM JULY TO OCT. BOJ CONSIDERS
MONEY DEMAND HAS IN NO WAY EASED. FAILURE OF PRODUCTION
TO KEEP PACE WITH DEMAND DUE IN PART TO DELAYED RECOVERY
OF INVESTMENT IN NEW MANUFACTURING CAPACITY, TO POLLUTION
AND ENVIRONMENTAL PROBLEMS WHICH HAVE MADE IT DIFFICULT TO
FIND NEW FACTORY SITES, AND TO FAILURE OF BUSINESS TO
ANTICIPATE STRENGTH OF RECOVERY. ALTHOUGH EPA APPARENTLY
PAYING MORE ATTENTION TO PAST DEVELOPMENTS, BOJ, LOOKING TO
FUTURE, CONSIDERS PROSPECT OF 34 PERCENT INCREASE IN
MACHINERY ORDERS (EXCLUDING SHIPS) DURING FOURTH QUARTER AS
FURTHER EVIDENCE THAT AGGREGATE DEMAND REMAINS STRONG.
THEREFORE, BOJ SEES NO NEED YET TO ALTER DEMAND MANAGEMENT
STRATEGY, ANTICIPATING REAL GNP GROWTH OF PERHAPS 11
PERCENT IN JFY 73 (ASSUMING UNRESTRICTED OIL IMPORTS), AND
AGAIN IN JFY 74.

4. IMPACT OF ENERGY CRISIS IS ALSO SUBJECT TO WIDELY
DIFFERING VIEWS. MOST FORECASTS BASED ON PAST RELATION-
SHIP BETWEEN OIL IMPORTS AND OUTPUT, THEN MAKING ASSUMPTION
OF PERCENTAGE CUTBACK IN OIL SUPPLIES IN ORDER TO ARRIVE AT
IMPLIED PERCENTAGE REDUCTION IN ECONOMIC OUTPUT. MITI
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MOST PESSIMISTIC, WITH ONE REPUTABLE ECONOMIST PROJECTING

35.6 PERCENT DROP IN INDUSTRIAL PRODUCTION INDEX (E.E. FROM 132 TO 85) FROM DEC TO APR ON BASIS OF 25 PERCENT CUT IN CRUDE IMPORTS ALONG WITH VERY LARGE DRAWDOWN OF DOMESTIC OIL STOCKS. ON OTHER HAND, EPA AND BOJ ASSUMING LESS THAN ONE FOR ONE IMPACT ON AGGREGATE OUTPUT. AGENCIES ALSO UTILIZING INPUT-OUTPUT MATRIX TABLE BUT CONSIDER RESULTS HIGHLY CONJECTURAL ON BASIS OF UNPUBLISHED 1970 COEFFICIENTS WHICH ALREADY SAID TO BE OUT OF DATE.

5. SOME ANALYSTS, NOTING FASTER GROWTH IN CRUDE OIL IMPORTS IN RECENT YEARS THAN IN RISE OF INDUSTRIAL PRODUCTION (E.G. 14.5 PERCENT VERSUS 8.9 PERCENT COMPOUND ANNUAL RATE 1970-73) CONCEDE POSSIBILITY OF ECONOMIZING IN DOMESTIC USE OF PETROLEUM PRODUCTS. THIS COULD PERMIT CONTINUED GROWTH IN INDUSTRIAL PRODUCTION EVEN THOUGH CRUDE OIL IMPORTS WERE RESTRICTED TO RECENT HIGH LEVELS. HOWEVER, EVENTUALLY BOTTLENECK PROBLEMS WOULD ARISE IN ONE INDUSTRY AFTER ANOTHER RESTRICTING OVERALL GROWTH. WHILE AGENCIES HAVE NOT YET FINALIZED THEIR ASSESSMENTS OF ECONOMIC IMPACT, EPA EVIDENTLY BELIEVES REAL GNP GROWTH RATE JFY 73 MIGHT DROP FROM 9 TO 7 PERCENT AND IN JFY 74 RANGE OF GROWTH ESTIMATE IS BETWEEN MINUS FIVE TO PLUS TWO PERCENT. BOJ SOMEWHAT MORE OPTIMISTIC WITH JFY 73 GROWTH DROPPING TO ONLY 9 PERCENT AND OUTLOOK FOR JFY 74 RANGING BETWEEN MINUS ONE TO PLUS 5 PERCENT.

6. GOVERNMENT AGENCIES AGREE THAT OIL SHORTAGES WILL LIMIT GROWTH ON SUPPLY SIDE AND THAT EXPECTED GROWTH IN DEMAND WILL THEN RESULT IN DEMAND/SUPPLY GAP. HOWEVER, VIEWS ON SIZE OF GAP VARY. DEMAND GROWTH ALSO IMPORTANT IN JUDGMENT AS TO EVENTUAL PACE OF INFLATION (IN SEPTEMBER WHOLESALE PRICE INDEX 18.7 PERCENT AND CONSUMER PRICE INDEX 14.6 PERCENT HIGHER THAN YEAR AGO). NEW FINMIN TADEA FUKUDA EVIDENTLY HAS BEEN GIVEN RELATIVELY FREE HAND BY TANAKA IN ESTABLISHING FUTURE ECONOMIC POLICIES. HAS PREVIOUSLY FAVORED LOWER LEVELS OF GOVT SPENDING. EMBASSY VIEWS OF POSSIBLE BUDGET STRATEGY BEING TRANSMITTED SEPTTEL.
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